

# **Tax Alert: Sum received under a Keyman insurance policy assigned before 1 April 2014 not taxable: Indore ITAT**

**Issued on: 28 February 2020**



## Summary

The Indore bench of the Income Tax Appellate Tribunal (ITAT) has held<sup>1</sup> that a Keyman Insurance Policy (KIP or the policy) taken by a company in the name of the Keyman (i.e. taxpayer's husband) becomes an ordinary life insurance policy once it is assigned to the taxpayer. Consequently, sum received by the taxpayer on maturity would not be taxable under the Income-Tax Act, 1961 (the Act).

It further held that the amendment<sup>2</sup> in the definition of KIP to cover assigned policies within its ambit is prospective in nature and accordingly, would only apply to KIPs assigned after 1 April 2014.

## Facts of the case

- Bhatia International Company Limited ('the Company') had purchased a KIP from Life Insurance Corporation of India (LIC) on the life of its Keyman (i.e. taxpayer's husband) in the year 2005 for a tenure of 10 years. The Company paid premiums till October 2010 and claimed deduction for the same<sup>3</sup>.
- The policy was assigned to the Keyman in March 2012, and the surrender value on the date of assignment was offered to tax by the company during Financial Year (FY) 2011-12.
- Post assignment, the policy continued as a normal life insurance policy and the premium was paid for the remaining tenure of the policy.
- Subsequently, the Keyman assigned the policy to his wife (i.e. the taxpayer) as a gift and the assignment was duly recorded by LIC.
- The policy was terminated prematurely in February 2015, and the proceeds were paid by LIC to the taxpayer after deduction of tax at source<sup>4</sup>.
- The taxpayer claimed the sum so received as exempt from tax in its return of income<sup>5</sup>. The tax officer allowed the exemption claim of the taxpayer.

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<sup>1</sup> Smt. Harleen Kaur Bhatia v. PCIT [2020] 114 taxman.com 183 (Indore -Trib.)

<sup>2</sup> vide Finance Act, 2013 in Explanation 1 to section 10(10D) of the Act with effect from 1 April 2014

<sup>3</sup> under section 37 of the Act

<sup>4</sup> under section 194DA of the Act

<sup>5</sup> applying provisions of section 10(10D) of the Act

- Later on, the Commissioner of Income Tax (CIT) issued<sup>6</sup> a showcause notice to the taxpayer in view of the amendment in the definition of KIP. According to him, the proceeds are taxable even if the assignment of the policy took place before the effective date of amendment.
- Aggrieved by the order of CIT, the taxpayer preferred an appeal before the ITAT.

### Taxpayer's contention before the ITAT

- **Nature of policy changed:** The taxpayer placing reliance on decision of Bombay<sup>7</sup> and Delhi<sup>8</sup> High Court, submitted that the nature of policy got changed from a KIP to an ordinary life insurance policy post its assignment from the company in favour of Keyman (i.e. taxpayer's husband). Thus, it argued that the sum received on maturity is exempt from tax under the Act.
- **Amendment is prospective in nature:** The taxpayer argued that amendment in the definition of KIP enhances the scope of taxability and hence should be prospective in nature. Further, without prejudice, the taxpayer submitted that the amendment would not apply in the instant case since the policy was assigned prior to the amendment effective date.

### Held by the ITAT

- **Amendment to apply prospectively:** The ITAT held that the amendment in the definition is prospective in nature and the same would not be applicable to the taxpayer since the assignment of KIP in favour of keyman (i.e. taxpayer's husband) was made in October 2010, and even subsequent assignment in favour of taxpayer was made in January 2013, which was much before the effective date of amendment i.e. 1 April 2014.
- **Order of the tax officer restored:** The ITAT held that the twin condition of order being erroneous and it being prejudicial to the interest of the revenue needs to be satisfied for invoking revisionary powers of the CIT. Thus, the ITAT restored the order of the tax officer since in the instant case, these conditions were not satisfied by the CIT.

<sup>6</sup> under section 263 of the Act

<sup>7</sup> CIT v. Prashant J. Agarwal [2016] 75 taxmann.com 54 (Bombay)

<sup>8</sup> CIT v. Rajan Nanda [2012] 18 taxmann.com 98 (Delhi) and DCIT v. Rajan Nanda [2013] 37 taxmann.com 335 (Delhi)

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## Our comments

The ITAT ruling provides much-needed clarity on taxability of proceeds from a KIP which have been assigned prior to 31 March 2014. It is a welcome decision for the taxpayers who have claimed exemption of the amount received under such assigned policies. It remains to be seen if the tax authorities challenge this decision at higher forums.

However, adopting a conservative view, insurance companies may continue to deduct tax from proceeds in such cases, till the issue is finally settled by the High Court/Supreme Court.

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